

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

76-6097/98/99

To Be Argued By
A. DAVID BENJAMIN

UNITED STATES COURT OF APPEALS

ORIGINAL
WITH PROOF
OF SERVICE

for the

SECOND CIRCUIT

DOCKET NO. 76-6098

F. W. EVERSLEY & CO., INC., & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by The East New York Non-Profit H.D.F.C., INC.,

Plaintiff-Appellee,

-v.-

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development, THE EAST NEW YORK NON-PROFIT H.D.F.C., INC., and THE EAST NEW YORK SAVINGS BANK,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing & Urban Development,

Defendant-Appellant.

DOCKET NOS. 76-6097, 76-6099

F. W. EVERSLEY & CO., INC., & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by Brownsville Housing Development Fund Corporation,

Plaintiff-Appellee,

-v.-

BROWNVILLE HOUSING DEVELOPMENT FUND CORPORATION, CARLA A. HILLS, Secretary of the United States Department of Housing & Urban Development and MANUFACTURERS HANOVER TRUST CO.,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing & Urban Development and MANUFACTURERS HANOVER TRUST CO.,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFF-APPELLEES

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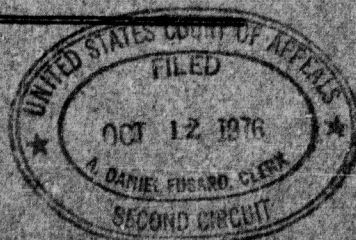


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PRELIMINARY STATEMENT

This brief is submitted on behalf of plaintiff-appellee, F. W. Eversley & Co., Inc. (hereinafter "Eversley"), in connection with the captioned appeals, which have been combined for purposes of argument. These appeals are taken by Carla A. Hills, Secretary of the Department of Housing and Urban Development (hereinafter "the Government"), from a judgment for money damages entered on April 27, 1976 in No. 76-6098 (A241), and by the Government and Manufacturers Hanover Trust Company (hereinafter "Manufacturers") from a money judgment entered April 19, 1976 in Nos. 76-6097, 6099 in the United States District Court for the Southern District of New York (B221) (both, Henry F. Werker, U.S.D.J.). The judgments were entered pursuant to an opinion of Judge Werker dated February 4, 1976 (A6-22).

Judge Werker's decision, and the judgments entered thereon, were issued in connection with motions by appellee for summary judgment pursuant to Rule 56 FRCP and cross-motions by the Government for summary judgment.

Appellee will adopt the manner of styling these appeals set forth in the Government's main appeal brief, at page 3 (hereinafter "HUD brief").

ISSUES PRESENTED

The issue presented by these appeals is not merely, as the Government would have it (HUD brief, p. 3), whether the District Court was correct in entering judgment in favor of Eversley and against the Government and Manufacturers. The issue to be addressed by this Court is whether, under the procedures and contractual relationships mandated by HUD for nonprofit Section 236 housing projects, the mere fact of mortgage defaults subsequent to completion of construction, or failure to go to "final closing", is an absolute bar to all claims by the general contractor for payment of amounts which the general contractor has admittedly earned and to which it is entitled. Stated otherwise, is the Government or lender, which will obtain title to the contractor's improvements through foreclosure, entitled to do so in these cases at the expense of the contractor despite the fact that the contractor is entitled to full payment for its performance.

FACTS

The instant appeals are cases involving two housing projects financed and constructed under Section 236 of the National Housing Act (12 U.S.C. §1715z-1). In both cases, in accordance with the usual governmental scheme, the owners are nonprofit sponsors, with zero independent assets, FHA insured mortgage loans of 100% of the total development cost, and monthly interest subsidies for the tenants of the projects for the life of the mortgages, all to produce housing for families of low income pursuant to the purposes of the Act. The District Court found that the purposes of the National Housing Act were to provide for construction of low-income housing, and also to encourage opportunities for employment of lower-income persons in connection with such construction (A17) (1968 U.S.C.A. News at 2877). Moreover, it was intended that the Act be effectuated by the participation of private contractors, such as Eversley.

The economic feasibility, the costs of completion, the construction plan and specifications, and the actual execution of the work and the operations of the project are subject to the minute scrutiny and supervision of FHA as the regulatory body overseeing the project. FHA insures both building loan advances and the permanent mortgages to protect the construction and permanent lenders against all risks of default, both as to principal and accrued interest. Upon any default by the mortgagor, the lender has the immediate

option of claiming from FHA under the mortgage insurance contract. The claim may be perfected either by the lender's foreclosing the mortgage, in which event the lender will be made completely whole by FHA mortgage insurance funds, or by the lender's assigning the mortgage to HUD (as was done in East New York), in which latter case FHA assesses a penalty of 1% of the amount of the mortgage then outstanding. (In Brownsville, the mortgage has been neither foreclosed nor assigned by Manufacturers, the lender.) In all events, the lender is insured to the extent of approved advances, plus interest accrued thereon.

The Government, in its brief (HUD brief, pp. 5-13) sets forth a lengthy exposition concerning the documents executed in connection with these projects. There is no substantive dispute concerning the contents of the documents; indeed, they speak for themselves and are set forth at length in the record. What is neglected in the Government's brief is any narrative which even remotely touches upon what actually happened in these cases. In order to give the Court a sense of the inequity which the Government's position, if sustained, would produce, we briefly touch upon the significant highlights.

The East New York Project

In East New York, the FHA agreed to insure a building loan from the East New York Savings Bank to the East New York

Nonprofit HDFC, Inc., in the total sum of \$3,626,400, to construct a low income housing project in the East New York section of Brooklyn, New York. According to the Lien Law affidavit annexed to the building loan agreement (A83), the total sum of \$2,829,087 was committed by the lender for the cost of the improvement of the premises. That sum, also, is the sum stated to be the amount recoverable by the contractor under its construction contract with the owner (A91) and the same sum established on the project financial estimate (FHA form 2264) and attached to the FHA commitment (A69, 70, 85-89). Eversley, a black contractor, executed the construction contract with the owner on February 17, 1971 (A90-97) and promptly commenced construction of the project. Eversley agreed that the sum of \$23,400 would be held in escrow to insure completion of offsite facilities (A99), and the owner executed an escrow agreement covering the same sum with the lender (A100-101), again, as required by the commitment.

During the course of construction, lasting approximately 20 months, requisitions for payment were submitted by Eversley to the owner, after approval by FHA, which were in turn submitted to the lender for purposes of making advances from the committed building loan funds. Payment to Eversley was, as a rule, promptly made until the final and pre-final requisitions were submitted. Additionally, certain changes in the work were required during

the course of construction, for which requests were made (A112-115, A183-192) in order to conform the actual construction to the plans which had previously been approved by FHA. Certain of the change orders requested extensions of the date of completion (A112-115), and certain other of the change orders were for additional work required for the project (A183-192). All change orders were approved by the FHA.

In October 1972, Eversley completed construction of the buildings, executed a request for permission to occupy (which was submitted to FHA), and obtained temporary certificates of occupancy from the City of New York (dated November 15 and November 17, 1972). Immediately, both buildings became income producing.

Thereafter, in February 1973, Eversley certified its actual costs to the owner (A116-120).

Thus, as of February 1973, Eversley was entitled to be paid the balance of its contract, consisting of \$176,971 in holdbacks, \$12,067 in approved change orders, \$7,500 placed in escrow with the lender to secure water and sewer charges unpaid by the owner, and \$23,400 from the offsite escrow account, for a total of \$219,938 (A129). However, Eversley was not to be paid, notwithstanding full completion and performance by Eversley of construction (A64). For over a year and a half, a final closing, at which the balance of the mortgage would be advanced and the permanent

mortgage consent and amortization schedule determined, pursuant to FHA procedures, was not held, through no fault of Eversley's. By the time a final closing was scheduled, for July 25, 1974, the owner was in arrears in payment of debt service, and the lender was demanding additional sums from the owner as reserves against future interest and tax payments (A65, 133-135). It appears that, as of the scheduled date of final closing, the sum of \$209,116.63 (A134) remained unadvanced from the committed building loan proceeds (the lender having continuously reduced the available sum by application to monthly interest charges). The lender's position was that the loan was not in balance as of the scheduled final closing, there being insufficient money remaining to cover the bank's requirements and insure payment to Eversley (A135; par. 4(e) of building loan agreement, A77). Thus, the scheduled closing broke up, the lender declared the mortgage to be in default, and elected to assign it to HUD pursuant to the provisions of its insurance contract (A123). Upon Eversley's claim that it was entitled to the unadvanced proceeds, for payment to it of the sums to which it had become entitled months previously, HUD took the position that it was entitled to offset that balance against the sums advanced under its insurance contract, thereby, in effect, making Eversley the only one who suffered because the owner was unable to

meet debt service payments from operating revenues long after the completion of the construction.

In short, although Eversley has fully performed his contract and completed the construction, including all changes and offsite facilities, the Government has argued that Eversley, rather than the Government, should bite the bullet and, in effect, pay for the owner's inability to meet obligations during operation. Eversley, to this date, has been put in a position of financing operation of the project to the tune of approximately \$220,000, even though the Government is in a position to acquire full title to the project, including all improvements made by Eversley, by foreclosing the mortgage assigned to it without paying full cost. Put this way, it is seen that the Government's position is to require the contractor to assume the risk of the owner's default during operations rather than the Government (at whose behest the owner was established and the project built in the first place). We submit that such a result was never intended by Congress, and to sustain the Government's position is to fly in the face of reason and good conscience, and would arrive at a totally unjust and inequitable conclusion.

The Brownsville Project

The facts in the Borwnsville case are similar to those in East New York. There, Eversley signed a construction contract with the owner on November 10, 1970, whereby,

in consideration of construction of the project, Eversley was to receive the costs of construction, plus a fee, not to exceed, in total, \$7,697,226 (B97). Construction was promptly commenced, during the course of which numerous change orders were requested and approved by the FHA (B160-177). The change orders amounted, in total, to \$129,409.20 (B42).

Eversley completed construction in August 1972 of the West building, for which a request for permission to occupy was executed on August 8, 1972, and a temporary certificate of occupancy issued by the City of New York on August 24, 1972 allowing the building to become income producing at that time. The East building was completed in January 1973, a temporary certificate of occupancy issued on January 18, 1973, and a permission to occupy issued on January 24, 1973. Thus, both buildings were immediately income producing. In short, construction was complete within the time required (as amended by approved change orders (B112), and Eversley became entitled to its holdbacks and change orders at that point.

As in East New York, payment to Eversley was to proceed upon a final closing held under the auspices of the FHA. Normally, if necessary, at such closing the mortgage would be increased to cover the list of the extras supplied by Eversley at the behest of the owner and FHA (B40). However,

a final closing has never been held; the reason appears to have been a dispute between the Government and the owner concerning disposition of AMPO funds (an acronym for "amounts to make project operational") by the owner (B44, 202-203). Absolutely no disputes have arisen with Eversley, nor has it been claimed that Eversley is in any way responsible for the fact that a final closing has not taken place. In fact, no one has criticized Eversley's performance at all. Nonetheless, since a final closing has not taken place, the Government has asserted, ad hominem, that Eversley is not entitled to be paid.

It will be seen, therefore, that, as in East New York, the Government is again attempting to oblige Eversley to assume the burden of nonpayment, notwithstanding the fact that (1) none of the problems which the Government claims exist were caused by Eversley, and (2) the Government will again be in a position to obtain the full value of Eversley's performance by foreclosure of the mortgage, without paying for it. Thus, once again, the Government insists that the contractor guarantee the owner's performance here with respect to funds placed in the owner's hands by the Government. Again, the Government takes a position which denies equity to the one party which deserves it: the contractor.

It will be seen from the facts outlined above that, if the Government's position were tenable, the Government

could always precipitate a situation such as that existing here, simply by delaying final closing to such an extent that the owner would inevitably default. Although the record does not reveal such motivation on the part of the Government in these cases, it is quite clear that any delays in final closing were not as a result of any actions by Eversley. In short, equitable considerations afford no basis to the Government's position; rather the equities lie solely with Eversley.

In both cases, the judgments simply oblige the Government (or Manufacturers) to expend the monies necessary to reach final cost, as found by HUD (A70, B69). By paying the judgments, the full amount anticipated to be expended for construction will have been expended, and instead of the Government acquiring a windfall, it will have paid for the value of its project.

The balance of this brief, therefore, will discuss the applicable legal theories, pursuant to which Eversley is entitled to recover the sums to which it has become entitled by virtue of performance of all of its obligations under its construction contracts, to avoid the inequitable result of the Government's position.

SUMMARY OF ARGUMENT

I. All monies as to which judgment was entered in the District Court were fully earned by Eversley prior to any defaults or declarations of default under the mortgages or the building loan agreements. Thus, and particularly as concerns the retainages, Eversley has an equitable lien upon those monies as of the date of its entitlement, which lien cannot be defeated by the owner's defaults, the acceleration of the mortgage balances, or the assignment of the mortgages to HUD.

II. At the time Eversley became entitled to the monies, those sums became trust funds for the benefit of Eversley and its subcontractors, notwithstanding the fact that they were still in the possession of the lender, and later assigned to HUD.

III. Eversley is a third-party beneficiary of the building loan agreement (and thus of the Government's endorsement of insurance thereon), and is therefore entitled to recover for the balance due under that agreement.

IV. The doctrine of sovereign immunity does not bar the maintenance of these actions, since the assertion of that doctrine is not sufficient to defeat Eversley's claims based upon the priority of its equitable liens, or its trust fund theory. Alternatively, since Eversley is a third-party beneficiary of the building loan agreement, and

express contract, as to which the Government is an assignee, sovereign immunity has been waived by virtue of the Tucker Act.

V. Eversley is entitled to interest upon the sums for which judgment was entered in the District Court.

ARGUMENT

As is evident from a reading of the District Court's opinion (A5-22), alternative theories were presented by Eversley to sustain its position that it was entitled to be paid all the sums as to which judgments have been entered. In East New York, judgment was entered in favor of Eversley in the total sum of \$200,166.95 against the Government, representing holdbacks of \$176,971.00, plus approved change orders in the sum of \$12,067.00, plus the amount remaining in the offsite escrow (\$23,400.00, less \$12,271.05 representing costs disallowed by FHA auditors) (A241-242). In Brownsville, judgment was entered in favor of Eversley, and against Manufacturers, in the total sum of \$572,104.00 representing holdbacks of \$461,807.00, plus approved change orders of \$110,297.00 (B221-223).

The balance of this argument will be divided so as to discuss, individually, each theory advanced by Eversley.

POINT I

EVERSLEY IS ENTITLED TO RECOVER ON
THE THEORY OF AN EQUITABLE LIEN.

We begin with the undisputed factual position that Eversley completed performance on both projects in issue, and therefore earned every penny to which it is entitled under both the construction contracts and approved change orders. This position is borne out by the record, which indicates that Eversley substantially completed both the East New York project (A109, 110, 111, 116, 117-120, 226) and the Brownsville project (B108, 109, 110, 111, 119-123, 201). Indeed, the Government does not dispute that Eversley substantially completed both projects, and further concedes that the owner's defaults were not caused by any wrongdoing on Eversley's part (HUD brief, page 6).

Crucial to these cases are the actual dates of completion of the projects, and Eversley's termination of further work in connection therewith. Construction in East New York was completed in October, 1972 and application for permission to occupy was executed on October 18, 1972 (A64, 109). There has been no claim that the owner was in default prior to that date. Even accepting the Government's contention at HUD brief, pages 14 and 15, it is evident that the Government executed a permission to occupy in respect to the East New York project on March 8, 1974 (A237), which

pre-dates by over six months the declaration of default by the East New York Savings Bank, lender therein, on September 13, 1974 (A123). Temporary certificates of occupancy were issued on November 15 and 17, 1972 (A110-111). In Brownsville, construction was completed in August, 1972 and January, 1973, and applications for permission to occupy were executed shortly thereafter (B41-42, 109-112), all prior to the owner's default (B144). The Government countersigned the permissions to occupy on or about June 12, July 16 and November 30, 1973 (B198-201); it is unclear from the record whether, in fact, the mortgage balance has ever been accelerated by Manufacturers. Indeed, it appears that Manufacturers has never taken any action to accelerate the mortgage balances, declare a default, or assign the mortgage to HUD (B143-144). In addition, temporary certificates of occupancy issued on August 25, 1972 and January 18, 1973.

In short, under any version of the circumstances of these cases, Eversley completed construction prior to any defaults by the owners or any elections on the part of the lenders to enforce the default provisions of the respective mortgages and building loan agreements.

It is submitted, consequently, that Eversley's entitlement to the balance remaining under the building loan agreements (consisting solely of holdbacks and escrows)

became fixed, at the latest, prior to any default or actions on the part of the mortgagees to enforce their rights upon default. It is further submitted that, upon such entitlement, an equitable lien in favor of Eversley, and its subcontractors, attached to those unadvanced monies, which lien could not and cannot be defeated by subsequent actions by either the lenders or the Government. Even assuming, as the Government insists, that the date of HUD's signing of the permission to occupy in East New York and Brownsville are the relevant dates, in both cases that occurred prior to any election to declare the mortgages in default and assign them to HUD (A237).

The District Court found that Eversley was entitled to an equitable lien upon the escrow funds and retainages withheld by the respective banks (A17), reasoning that, otherwise, HUD or Manufacturers would be "unjustly enriched" through foreclosure of the mortgages, thereby obtaining the value of Eversley's performance without paying for it. The Court cited the case of American Fidelity Fire Insurance Company v. Construcciones WERL, Inc., 407 F.Supp. 164 (D.V.I. 1975). That case involved an action by the surety of the general contractor against the owner, the lender and the Government, wherein the surety sought a judgment or order against the Government for construction holdbacks. In the

course of a lengthy discussion by the Court concerning two other leading cases pertinent to the facts at bar in both the WERL case and the instant case (407 F.Supp. at 178-184), the Court therein held that the retainages constituting the unadvanced building loan proceeds were an identifiable res, and found that an equitable lien would be impressed upon those funds for the benefit of the contractor which earned them (and, therefore, its surety). The Court reasoned, first, that the retainages constituted an identifiable res upon which such a lien could be placed, and, second, that the imposition of an equitable lien upon that res was proper because:

"The funds may be called undisbursed mortgage proceeds in the hands of the lender, contractual retainages in the possession of the borrower, and earnings when received by the contractor. Nevertheless, they are ultimately designed to be paid to the general contractor in return for his successful performance under the construction contract."
(407 F.Supp. at 183).¹

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1. The Government's attempt to distinguish this case (HUD brief, p. 41) cannot be sustained. While the Court did find that HUD accepted the surety's performance in completing construction, the Court also found for the contractor on an equitable lien theory (407 F.Supp. at 183-184). In this respect, the WERL case and the present cases are indistinguishable. In any event, HUD has accepted Eversley's performance in the instant cases, as previously noted; since the surety's position in WERL was the equivalent of its principal's (had the latter completed construction), the purported distinction advanced by the Government lacks merit.

As has already been noted, Eversley's performance on both projects under consideration herein has been fully completed. Thus, under the holding of the WERL case, an equitable lien arose in favor of Eversley on the undisbursed building loan proceeds upon Eversley's completion of construction.

See, also, G. L. Wilson Building Co. v. Leatherwood, 268 F.Supp. 609 (W.D.N.C. 1967);

Swinerton & Walberg Co. v. Union Bank, 25 Cal. App. 3d 259, 101 Cal.Rptr. 665, 54 ALR 3d 839 (D.C. App. 1972);

Cf. Henningsen v. United States Fidelity & Guaranty Co., 208 U.S. 404 (1908).

Since Eversley acquired an equitable lien upon the retainages as of the first date of its entitlement thereto, which date occurred prior to any defaults or actions by any mortgagee in these cases to enforce rights upon default (whether, electing to accelerate the balance, by either foreclosing or assigning the mortgage to HUD), it is evident that such lien cannot be defeated by subsequent events which occurred without the participation, and through no fault of, the lienor, Eversley. See Prairie State National Bank v. United States, 164 U.S. 277 (1896); East End Bank v. Childress, 322 F.2d 563 (5th Cir. 1963). In short, Eversley's equitable lien, having attached to the undisbursed mortgage proceeds and being prior in right to the bank's rights to set off those

sums against the balances due (such rights arising only upon a declaration of default) (A78, B79), cannot be impaired or defeated by junior entitlements which may be claimed by the banks or HUD. American Fidelity Fire Co. v. Construcciones WERL, Inc., supra. Cf. United States v. Lincoln Neighborhood Community Assn., No. 73-30 (N.D. Fla. 1975), app. pending No. 75-4069 (5th Cir.) (HUD pamphlet of unreported decisions at 2, 8-9).

It would no doubt be urged by the Government and Manufacturers that such a doctrine does not apply in the ordinary case, where a lender enters into a building loan agreement with a private owner, who in turn enters into a construction contract. The distinctions between the case just posed and the situation presented herein is that the owners of these projects were at all times nonprofit companies, with no assets of their own from which recovery could be had by the contractor; in fact, the owners, as noted by the District Court, were "the creatures of HUD" (A13), formed to accomplish the Government's purposes, not their own (private) ends. The requirement that holdbacks be retained by the lender is imposed by HUD, and is not the result of bargaining by the owner, lender and contractor.² And, since

2. It is worth noting that HUD recently promulgated new proposed rules which would significantly alter the

the owners are without independent assets, only the building loan fund itself provides monies to insure that interest will be paid. When delays occur in closing, the owners inevitably default for want of funds to maintain the loans in balance. (Here, such delays occurred through no fault of Eversley's.) Further, Eversley was obliged to waive any right to file a mechanic's lien, or maintain any claim against the owner's real estate, in each of the construction contracts in issue (A92, B101).³ Thus, this is emphatically not the ordinary situation but, rather, one in which it could not be clearer that Eversley is entitled to an equitable lien upon the undisbursed mortgage proceeds, which lien survives any later assertion of rights by the lender.

existing practice concerning holdbacks. 41 Fed. Reg. 37226 et seq. (No. 172, September 2, 1976). Under the proposed rule changes, Title 21 C.F.R., the lender would be required to segregate holdbacks in separate escrow accounts, to be paid directly to the contractor upon substantial completion. The evident purpose of those proposed amendments is to relieve the contractor of the burden of relying on the sponsor's performance to obtain its own earned entitlement. In effect, HUD recognizes the inequity of its own position advanced in these appeals. (The proposed rules are set forth following this brief.)

3. Indeed, Eversley was obliged to further bind itself to obtain waivers or releases of liens from all subcontractors and materialmen (A91, B97). This this situation more nearly resembles that pertaining to liens upon public improvements, where the contractor, rather than placing a lien upon the improved realty, retains a lien upon balances remaining in the hands of the government-owner. N.Y. Lien Law §§5, 12. [In New York a waiver of lien is now against public policy. L. 1975 c 74; N. Y. Lien Law §34 (McKinney's Supp.).]

Finally, in view of the above, it is apparent that the mere assignment of the note and mortgage in East New York to HUD could not abrogate Eversley's equitable lien. (In Brownsville, no assignment of the mortgage has taken place.) The Government, which obtained the assignment in East New York in a proprietary, rather than a governmental capacity, can obtain no greater rights as against Eversley than its assignor had. This principle of law is even recognized in the case of Trans-Bay Engineering & Builders, Inc. v. Lynn 396 F.Supp. 265, 272 (D.D.C. 1975), upon which the Government places great reliance.

See, also, Travelers Indemnity Co. v. First National State Bank of New Jersey, 328 F.Supp. 208, 216 (D.N.J. 1971).⁴

We note, again, that Eversley's equitable lien attached to an identifiable res; this is, in fact, acknowledged

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4. The Government's attempt to distinguish the Travelers case, at HUD brief, pp. 41-42, is to no avail. The Government contends that the building loan agreement in Travelers did not contain the language of paragraph 4(e) of the building loan agreements in the instant cases, which requires that the loan remain in balance at all times. However, the Travelers agreement (A208-216) provides in paragraph 10 that the lender, upon default, may take possession of all unadvanced sums and all sums in escrow (A210). Since, as noted previously, the operative fact is not whether the bank in either of the instant cases was entitled to declare a default because the loan was not in balance, but rather whether Eversley's entitlement to the holdbacks is superior to any rights of the lenders, the asserted distinction between the two agreements should make no difference to this Court's determination.

in 12 U.S.C. §1713(g) and 24 C.F.R. §§207.225 and 207.258, which require the lender to assign, not only the mortgage note and mortgage, but, as well, any sums remaining unadvanced on the loan and any cash held in escrow. (The provisions of the statutory section are set forth at HUD brief, pp. 9-10.)

The Government, in answer to Eversley's theory of an equitable lien, relies primarily upon Trans-Bay Engineers & Builders, Inc. v. Lynn, 396 F.Supp. 265 (D.D.C. 1975), app. pending Docket No. 75-1976 (D.C. Cir., argued September 29, 1976) (HUD brief, pp. 39-40). With respect to this theory, Judge Smith declared that "equitable lien principles cannot create vested rights in Trans-Bay which are contrary to express and implied contractual undertakings" (396 F.Supp. at 272). With due respect, we submit that Judge Smith's reasoning was incorrect. As was noted by Judge Young in American Fidelity Fire Insurance Co. v. Construcciones WERL, Inc., supra, 407 F.Supp. at 184:

"In short, since the basis of recovery under quantum meruit is the principle that it would be inequitable and unjust for the defendant to retain the benefits conferred upon him by the plaintiff's performance without paying therefor, Judge Smith erred in declaring that equity cannot set aside legal obligations. The legal obligations are not set aside; they are surmounted and transcended by equitable considerations." (Emphasis in original.)

The situation is no different here where HUD, through foreclosure of the mortgages in questions, will be unjustly enriched by obtaining value of Eversley's performance without paying for it. Such circumstances require the imposition of an equitable lien in favor of Eversley, which is sought to be enforced herein, on the undisbursed building loan proceeds, which lien may not be defeated by the Government in its opposition.

The Government also relies upon the case of Modular Technics Corp. v. South Haven Houses HDFC, 403 F.Supp. 204 (E.D.N.Y. 1975), aff'd mem. Docket No. 76-6025 (2nd Cir. June 8, 1976) (HUD brief, pp. 34-36). Although the facts are similar to the cases at bar, Modular Technics is readily distinguishable upon the ground that plaintiff therein sued on two theories only: contract between HUD and the contractor, and misrepresentation by the FHA as "quasi-agent" for the owner. In denying relief to the plaintiff, the Court specifically held that the doctrine of sovereign immunity barred relief, stating that "misrepresentation" (a tort) was excepted from the waiver provisions in 28 U.S.C. §2680(a) and that neither the Tucker Act (28 U.S.C. §1346) nor 12 U.S.C. §1702 waived sovereign immunity to suit under the contract alleged. In contrast, Eversley sues herein on theories of equitable lien, trust fund, and third-party beneficiary and, as is

discussed, infra (pp. 43-47), the doctrine of sovereign immunity is not a bar to recovery under those theories.

Finally, the case of United States v. Lincoln Neighborhood Community Assn., No. 73-30 N.D. Fla. October 16, 1975) app. pending No. 75-4069 (5th Cir.), set forth in the Government's pamphlet of unreported decisions, supports Eversley's view rather than the Government's. While it is true that the Court refused to order the retainages be paid to the contractor, the Court further noted, at pp. 7-8 (HUD Pamphlet, pp. 8-9), as follows:

"With respect to the unpaid progress advances 15 and 16 which became due prior to Lincoln's default, the court finds that Lincoln's contractual duties to submit the pay requisitions to the lender for payment to the contractor were ministerial only. Lincoln's failure to present these requisitions prior to default does not bar the contractor's right to payment since, under the contract, the lender became obligated thereon and would have paid the claims had Lincoln, not being in default, merely presented them. B & H, under its agreement was entitled to receive from Commonwealth pay estimates 15 and 16 in the amount of \$12,411.00, for work completed prior to notice of default on July 20, 1972, and Commonwealth did not make these payments. The building and loan agreement, made a part of the mortgage, required these payments to be made. Plaintiff' acquiring the mortgage by assignment, is bound by and should be held to comply with this agreement of Commonwealth with such amount, with interest at 6% from June 20, 1972, paid by it to B & H, and with, of

course, such amount so paid added from the date of payment to the total amount secured by the lien of the mortgage it acquired."

The situation in these cases, as pointed out previously, is no different. Eversley completed performance and earned the balance of its contracts (retainages, escrow and extras) prior to any defaults or actions by the lenders or HUD to enforce the default provisions of the documents.⁵ That being so, Eversley is entitled to be paid.

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5. In fact, in Brownsville, Manufacturers has never formally declared a default or taken any action pursuant thereto. As late as May 29, 1975, Manufacturers was still sending bills to the owner (B125).

POINT II

EVERSLEY MAY RECOVER AS BENEFICIARY
OF A TRUST FUND UNDER THE LIEN LAW
OF THE STATE OF NEW YORK.

Eversley advanced the theory, not ruled upon by the District Court, that the undisbursed mortgage proceeds held by the lenders constituted trust funds under the Lien Law of the State of New York, as to which it and its subcontractors were statutory beneficiaries, and, therefore, those parties were entitled to be paid by the present holders of the funds (the Government in East New York and Manufacturers in Brownsville). The Lien Law affidavits annexed to the building loan agreements at bar verify that the sum of \$2,829,807 was committed for construction in East New York and that the sum of \$7,967,226 was likewise committed in Brownsville. These allocations for construction were made to inform laborers and materialmen of the amount of money to be advanced under the building loan agreements and to enable those laborers and materialmen to rely on the fact that sufficient monies would be advanced in payment of the services to be rendered by them.

New York State Lien Law, §22 (McKinneys 1966);

P. T. McDermott, Inc. v. Lawyers Mortgage Co. 323 N.Y. 336, 341 (1922).

As monies so allocated for the improvement of real property are earned by the contractor and advanced to the owner, they become trust funds under Article 3-A of the Lien Law. It has been held that this article

"was designed to create trust funds to assure payment of . . . contractors, architects, engineers, surveyors, laborers and materialmen (Lien Law, Sections 70, 71; Caristo Constr. Corp. v. Diners Financial Corp., 21 N.Y.2d 507, 512-514, 289 N.Y.S.2d 175, 178-180, 236 N.E.2d 461, 463-464)."

Forest Electric Corp. v. Century National Bank & Trust Company, 70 Misc.2d 190, 333 N.Y.S.2d 644, 646 (Sup. Ct. N.Y. Co. 1970).

By labeling monies due or to become due owners in connection with the improvement of real property "trust funds," the legislature has established a scheme of protection to laborers and materialmen who render valuable services. And, once payments or monies are deemed to be "trust funds," they cannot be diverted to any other recipients, including the very lending institutions advancing the funds; trust funds must be paid only to the intended beneficiaries -- laborers and materialmen. As stated by the New York State Court of Appeals in Aquilino v. United States of America, 10 N.Y. 2d 271, 278-79 (1961):

"The policy proclaimed by our statute is to protect those whose skill, labor and materials made possible the performance of a construction contract and who in fact, creating the improvement, actually gave rise to the owner's obligation to pay. The legislature sought to assure that funds received from an owner should 'reach [their] ultimate destination -- material and labor.'"

The legislative intent to insure that laborers and materialmen are compensated for the services they perform is also revealed in the report of the Law Revision Commission recommending the adoption of the Lien Law trust fund provisions added in 1951:

"The New York Lien Law contains a set of provisions declaring that certain funds are trust funds and stating the purposes for which they are to be used. These provisions were intended to insure that moneys earned in the performance of a contract for either a privately owned improvement or a public improvement will in fact be used to pay the costs of that improvement." 1959 McKinneys Session Laws of N.Y. 1601, 1959 Leg. Doc. No. 65 P(F).

See, also, Palm Beach Realty Co. v. Harry J. Kangieser, Inc. 36 Misc.2d 1058, 233 N.Y.S.2d 641 (Sup.Ct. N.Y. Co. 1962), aff'd 243 N.Y.S.2d 413 (1st Dept. 1963) (not off. rep.).

At bar, the trust funds held back never found their way into the possession of the owner. This circumstance, however, does not deprive the holdbacks of trust fund status. The monies were earned by Eversley and were being held by the

mortgagees on behalf of the owners pending final endorsement and closing of the project.

United Lakeland Air Conditioning Co., Inc. v. Ahneman-Christiansen, Inc., 33 Misc.2d 606, 226 N.Y.S.2d 532 (Sup.Ct., Nassau Co. 1962), aff'd 18 App.Div.2d 1022, 239 N.Y.S.2d 38 (2nd Dept. 1963);

See, also, Utica Sheet Metal Corp. v. J. E. Schechter Corp., 47 Misc.2d 920, 262 N.Y.S.2d 583 (Sup.Ct. Albany Co. 1965);

Pearlman v. Reliance Insurance Company, 371 U.S. 132, 138 (1962).

In United Lakeland the Court stated, at pp. 537-538 of 226 N.Y.S.2d:

"[T]he deposits were trust funds within the meaning and contemplation of Section 36 [predecessor to §70] and subdivision (3) of Section 13 of the Lien Law. [The bank's] contention that no trust res ever came into existence because the funds in issue were not 'advanced' to or 'received' by the building corporations, but were at all times 'withheld' by it pending completion of the improvements, exalts bookkeeping methods over substance. Whether an amount was deducted from the last building loan advance or deposited with [the bank] by check of the building corporations simultaneously with the last advance to them by the bank, the legal effect was the same. The building loan agreement was closed out; a new contractual relationship with the purchaser was established by the extension agreement

* * *

"It is also to be noted that subdivision (3) of section 13 of the Lien Law states that the trust res shall consist of the 'right to receive advances as distinct from advances actually received' and section 36 of the Lien Law provides that 'for the purposes of a civil action only, the trust funds shall include the right of action upon a building loan contract, mortgage or conveyance for moneys due or to become due thereunder to the owner, as well as moneys, actually received by him.' So even if the funds were not technically 'advanced,' they were still impressed with the statutory trust."

In an attempt to disregard the salutary provisions of the Lien Law, which accord trust fund status to the retainages held back by the mortgagee, the Government argues that contractual rights allow the banks to retain the holdbacks and, rather than pay them to the parties having rightful claims (the contractor, laborers and materialmen), offset these funds against their own outstanding mortgage balances. however, in so arguing, the Government and the mortgagees disregard that the equitable trust fund concept transcends contractual rights and is applied for the purpose of accomplishing the ends of substantial justice.

Under the building loan agreements, the mortgagees need not continue advances when the owners are in default, and, in both cases, the owners are in default. (The defaults, of course, occurred after Eversley's full performance of its contract.) The mortgagees, supported by HUD, have argued

that the payments of the holdbacks are advances they need not make, and they wish to reduce the outstanding balances of the mortgages by deducting the holdbacks from the total amount committed for construction. In accordance with HUD regulations, the outstanding mortgage balance is not only the principal sum advanced, but accrued interest to the date of default and, indeed, until payment from HUD under the insurance policy.

The application of equitable trust fund principles will prevent this end; such reductions would be a prohibited diversion (Caristo Construction Corp. v. Diners Financial Corp., 21 N.Y.2d 507, 289 N.Y.S.2d 175), and despite the proclaimed contractual rights of the banks, or the Secretary as assignee, final "advances" of the holdbacks must be made.

Additionally, no purpose was being served by a prolonged holdback of the retainages: the projects are and were complete. The sole purpose of the holdback is enunciated by HUD in paragraph 1-4 of its handbook,⁶ as follows: "The undisbursed holdback provides a major incentive to the contractor to complete his performance." Here, where performance was complete, the only use of the holdbacks, if

6. Set forth, infra, following the text of this brief, as an appendix.

the Government were to be sustained, would be to eliminate the Government's risk as the issuer of the mortgage.

Furthermore, it is submitted that, at the time Eversley was first entitled to be paid the holdbacks remaining on its contract (i.e., the undisbursed mortgage proceeds), the respective lenders in each case became agents of the owners, or trustees of those funds for the benefit of the owners and their contractor. Since the building loan agreements in both cases provide that the lender shall withhold, from each advance, a 10% holdback, which is followed through in both construction contracts by entitling the owner to withhold 10%, in effect, the lender in each case acted on behalf of the owner in retaining the 10%. Although the documents do not so state explicitly, we believe it apparent that the clear intent of the documents was to prevent holdback monies from coming into the hands of the owners, which would not be disbursed to the contractor until completion. This accords with the factual situation present in these appeals, where the owners were no more than "shells" created solely to accomplish the Government's purpose of constructing low income housing.⁷

7. It will be noted that in the Brownsville case, the reason no final closing has been held is a dispute between HUD and the sponsor concerning disposition of AMPO funds, which were paid directly to the owner (B202-203).

Additionally, the assignment to HUD of the undisbursed mortgage proceeds and escrow monies held by the East New York Savings Bank could not serve to divest those funds of their character as trust funds. As noted previously, the Government was acting in a proprietary capacity, and would take an assignment of such funds subject to any liens, trusts or other equities which existed upon the date of the assignment.

In sum, therefore, despite the claimed contractual rights of the mortgagees to hold further construction advances, because the projects have been completed, the designed purpose of the holdback has been fulfilled, and the monies held by the mortgagees (or HUD) are trust funds which cannot be devoted to any purpose other than the payments of laborers and materialmen, an immediate release of the trust funds, with interest, should be ordered.

POINT III

EVERSLEY IS A THIRD-PARTY BENEFICIARY OF THE BUILDING LOAN AGREEMENT.

In Brownsville, the holdback fund remains in possession of the mortgagee, Manufacturers. In East New York, because of the assignment of the mortgage to HUD, the holdback fund was either improperly diverted to the mortgagee, (in violation of the New York State Lien Law), in reduction of the mortgage indebtedness, or was transferred to HUD. In either case, the holdback funds should be disbursed to Eversley and its subcontractors as third-party beneficiaries of the building loan agreements. Travelers Indemnity Co. v. First National State Bank of New Jersey, 328 F.Supp. 208 (D.N.J. 1971).

In Travelers, the mortgagee assigned the mortgage to the Secretary and transferred with it, pursuant to 12 U.S.C. §1713(g)(4)(5), the balance of the undisbursed mortgage funds. The suit was instituted directly against the Secretary by the co-trustees in bankruptcy of the contractor and the surety company that issued a dual obligee bond on behalf of the contractor.

Recognizing the existence of an identifiable fund for the payment of laborers and materialmen, the Court looked to the National Housing Act and the regulations of the Department of Housing and Urban Development. Having

acknowledged the existence of funds retained by the mortgagee during the course of construction (238 F.Supp. at 211), and the obligation to disburse those funds at the conclusion of the project (whether the funds remained in possession of the mortgagee or were transferred to HUD), the Court also acknowledged that the contractors were entitled to those funds as third-party beneficiaries. This finding merely restated the well-settled principles of law which entitle persons other than direct parties to the contract to recover on the contract, or on a surety bond, where those persons seeking relief are the intended beneficiaries of the contract.

German Alliance Insurance Co. v. Home Water Supply Co., 226 U.S. 220, 230;

Pearlman v. Reliance Insurance Co., 371 U.S. 132, 138 (1962).

See, also, citations noted by the District Court at page 11 of its opinion (A16).

The Court in Travelers stated:

"This court deems the plaintiffs to be creditor third-party beneficiaries of the building loan agreement, and the Secretary to be the assignee of said agreement." (328 F.Supp. at 211)

The Court arrived at this by an analysis of the building loan agreement and mortgage documents, which are essentially the same as those before this Court. In Travelers, as in the cases at bar, the building loan agreement contained the language that

"The borrower covenants that it will receive all advanced hereunder as a trust fund to be applied first for the purpose of paying for the cost of the improvements. . . ." (id. at 212)

In the cases at bar, the building loan agreements provide also

"The borrower covenants that it will hold in trust each advance hereunder for application to the items for which such advance was requested and approved." (Paragraph 4(d), A77, B78)⁸

The Court in Travelers then invoked the provisions of 24 C.F.R. §207.3(b) to conclude that the undisbursed proceeds of the building loan agreement must be disbursed for the benefit of the contract, stating:

"Nothing in the above described agreement contravenes or modifies the basic regulatory obligation of the Bank and its assigns to extend the full amount of credit under the building loan agreement where there has been no notice of termination of the project and the project has been satisfactorily completed. The said regulatory obligation is embodied in 24 C.F.R. §207.3(b):

'The mortgagee shall be obligated, as a part of the mortgage transaction, to disburse the principal

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8. The Government's attempt to distinguish Travelers on the basis of a difference in the provisions between the respective building loan agreements is discussed, supra, in a footnote at page 22 of this brief.

amount of the mortgage, to, or for
the account of the mortgagor or to
his creditors for his account and
with his consent." (emphasis in
original) (Id. at 213)

By analogy with Travelers, the projects here have been completed; however, because of the failure of the projects to close (an operation solely within the control of the Government), no monies have been paid either to the owner or to the contractor.

In Travelers, the Court also found an independent basis for granting judgment to the surety. It noted that the 10% retention mechanism had the effect of making the owner its own surety with respect to the completion of construction. Thus, under the building loan agreement, the mortgagor agrees to permit the mortgagee to hold back the same 10% retention monies that the general contractor agrees the mortgagor can hold back, until final completion of the project. Had those funds been paid monthly, as earned, to the owner, there would be no question as to the contractor's entitlement to those retention funds upon completion of the construction. Pearlman v. Reliance Insurance Co., supra, 371 U.S. at 141.

The situation is no different here. During the course of construction, the mortgagees held back 10% of the monies due Eversley with the purpose of insuring the completion

of the project (HUD Handbook, paragraph 1-4, reprinted following this brief). As noted, that purpose has been served, and the holdbacks should be paid to Eversley, as though it were a surety who undertook to complete the construction, as in Travelers and WERL.

Eversley, therefore, as a third-party beneficiary of the retained funds, which are also trust funds under the law of the State of New York, is entitled to those funds to the exclusion of the claims made by the Government and the mortgagees.

The Government strives mightily to destroy Eversley's argument (HUD brief, pages 19-29). In essence, the Government makes two arguments: first, that the Government's extensive involvement in the projects in issue was solely for the Government's protection, and there was no intent to benefit the contractor thereby, and second, that even if Eversley and its subcontractors were third-party beneficiaries herein, they could not prevail because their rights could be no greater than the owners' under the building loan agreements.

As to the first position advanced by the Government, we note that, regardless of whether the Government's involvement in these projects existed only to protect the Government with respect to its insurance, that in no way abrogates the status of Eversley as third-party beneficiary

of the building loan agreement. As noted in Travelers, the contractor and subcontractors are third-party beneficiaries of the building loan agreement, and as such, they are entitled to claim the undisbursed proceeds from the Government as assignee of that agreement and funds. This is recognized even in Trans-Bay Engineers & Builders, Inc. v. Lynn, supra, cited extensively by the Government in support of its arguments, wherein Judge Smith stated:

"This Court is in accord with the Travelers holding that a contractor may sue as a creditor-beneficiary of a financing agreement made on its behalf." (396 F.Supp. at 270)

As to the Government's argument, that Eversley was not the intended beneficiary of the building loan agreements, the question must then be answered, for whose benefit were those agreements executed? Clearly not the owners, since the entire scheme of construction seems to have been structured in such a fashion as to prevent the owners from ever laying hands upon any money involved. By the same token, the lender is only the incidental beneficiary of the provisions of the building loan agreement; in fact, the lender benefits primarily from the Government's agreement to insure its position. We submit that the public, pursuant to the provisions of the building loan agreement, and a fortiori, the contractor, whose skill and effort causes the purposes of the Act to be executed, is also.

As the District Court observed in its opinion
(A21, footnote 7):

"The purpose of §236 of the National Housing Act is not to produce revenue but to provide housing for low and middle income individuals. . . . the purpose of §236 was to insure decent housing for low and moderate income families, clearly a nonmonetary purpose."

By parity of reasoning, Eversley, as the instrumentality through which construction of the housing projects in issue, and thus the purposes of the Act, was to be achieved, is the intended third-party beneficiary of the building loan agreement, and is entitled to enforce its rights thereunder. And we point out, once again, that the public policy of the State of New York is to protect contractors, laborers, materialmen and mechanics by providing for liens, imposing trust requirements, and otherwise creating rights not explicitly recognized in contract.

To the extent that, as stated by Judge Smith in Trans-Bay (396 F.Supp. at 270), "the beneficiary cannot accept the benefits and avoid the burdens or limitations of the contract", we respectfully disagree with that statement insofar as it pertains to the facts in this case, and urge this Court not to adopt that position. To do otherwise would be to perpetuate a scheme whereby the Government or its assignor, through foreclosure, unjustly obtains the

value of the contractor's performance without full payment therefor and transfers the risk of the success of the projects, even after completion of construction, from the Government to the contractor, clearly not within the intentment of the statutory scheme. Since Eversley completed performance of its obligations on the projects, defaults by the owners may not be interposed to defeat Eversley's claims to full payment as third-party beneficiary.

POINT IV

THE DOCTRINE OF SOVEREIGN IMMUNITY IS NO BAR TO THESE ACTIONS.

The Government asserts (HUD brief, pp. 37-38) that the Government has not waived its immunity from suit with respect to Eversley's actions herein, and therefore, the actions should be dismissed, pointing to the holding in Modular Technics v. South Haven Houses HDFC, 403 F.Supp. 204 (E.D.N.Y. 1975), aff'd mem. Docket No. 76-6025 (2nd Cir. June 8, 1976).

In Modular Technics, as the Government correctly points out, the action by the contractor, as against HUD and the FHA, was dismissed upon grounds of sovereign immunity, and this Court affirmed the dismissal, citing United States v. Neustadt, 366 U.S. 696 (1961). However, it appears from the reported decision in the District Court that the plaintiff therein never advanced any of the theories asserted by Eversley in the instant cases. Rather, the contractor in Modular Technics asserted the allegations in his complaint as set forth at HUD brief, p.35. Those allegations, however, only assert direct contract claims as between the contractor and HUD and a claim based upon misrepresentation; it does not appear that the contractor ever asserted an equitable lien to the funds (as to which the Government is a holder), or a trust fund theory. Thus, the opinion in

Modular Technics does not advance the Government's position, and is clearly distinguishable, as noted above.

In fact, we submit the issue of sovereign immunity does not even arise in these cases. Insofar as Eversley has an equitable lien upon the unadvanced portions of the building loan agreements, the instant actions seek to enforce those liens against property in the hands of the United States, as to which the Government either cannot assert the bar of sovereign immunity, or alternatively, has waived sovereign immunity by virtue of 28 U.S.C. §2410, which states in part:

" . . . the United States may be named a party in any civil action or suit in any district court, or in any State court having jurisdiction of the subject matter -- (2) to foreclose a mortgage or other lien upon . . . real or personal property on which the United States has or claims a mortgage or other lien."

Insofar as Eversley and its subcontractors are entitled to the funds as statutory trust beneficiaries, such an entitlement cannot be defeated simply because the federal government, rather than a private party, holds the funds upon which the trust is impressed. When the Government acquires property, or executes a contract, within a State, the Government's rights are controlled by the law of the State.

Avco Delta Corporation Canada, Ltd. v. United States, 484 F.2d 692, 697 (7th Cir. 1973);

United States v. Fallbrook Public Utility District, 165 F.Supp. 806 (D.Cal. 1958);

Werner v. United States, 10 F.R.D. 245, aff'd 188 F.2d 266 (D. Cal. 1950).

And the Lien Law (N.Y.) draws no distinction between trustees in actions to enforce a statutory trust.

Finally, insofar as Eversley and its subcontractors are third-party beneficiaries of the building loan agreement, we note simply that Eversley is seeking to enforce obligations under an express contract, as to which the Government is an assignee only, and therefore, the case falls within the express contract provisions of the Tucker Act (28 U.S.C. §1346). In short, although the Government seeks to characterize Eversley's claims as arising out of a contract implied in law, such a characterization is inaccurate; rather, Eversley's claims arise out of either lien or trust principles, or express contracts, as to which sovereign immunity either is not applicable, or has been waived.

More significantly, we submit that the Government has waived its sovereign immunity in these cases, as well as those others which have discussed these issues, by virtue of its enactment of the "sue and be sued" clause contained in 12 U.S.C. §1702. That section provides, in pertinent part, as follows:

"The Secretary shall, in carrying out the provisions of this subchapter and subchapters II, III, V, VI, VII, VIII, X, XI-A and XL-B of this chapter, be authorized in his official capacity, to sue and be sued in any court of competent jurisdiction, State or Federal."

It will be noted that Section 236 of the National Housing Act, 12 U.S.C. §1715z-1, under which the projects in question were built, is contained in subchapter II, and the language of Section 1702 is certainly broad enough to encompass the present actions, cf. National State Bank v. United States, 357 F.2d 704, 711 (Ct. Cl. 1966). There are no exceptions in the statutory language to indicate that the instant actions are not included in the waiver of sovereign immunity, and in view of the fact that the law favors a liberal construction of waivers of sovereign immunity [Federal Housing Administration Region No. 4 v. Burr, 309 U.S. 488 (1940)], we submit that the Government is not immune from suit herein. Furthermore, prior actions which have dealt with the same issues as those at bar have all recognized the jurisdiction of the Federal District Courts to adjudicate those issues on the merits.

Trans-Bay Engineers & Builders, Inc. v. Lynn, supra, 396 F.Supp. at 268;

Travelers Indemnity Company v. First National State Bank of New Jersey, supra, 328 F.Supp. at 211-212;

American Fidelity Fire Insurance Company
v. Construcciones WERL, Inc., supra,
407 F.Supp. at 186-187;

United States of America v. Lincoln
Neighborhood Community Assn., supra,
HUD Pamphlet at 8.

Insofar as the District Court in Modular Technics
v. South Haven Houses HDFC, supra, held that 12 U.S.C. §1702
did not confer waiver of sovereign immunity, we note, as
previously, that the complaint in that action did not in-
corporate the bases of liability advanced herein, and
should not be followed on these appeals.

In conclusion, under any one of the theories
advanced above, Eversley is entitled to recover for the full
value of its performance of its contracts herein.

POINT V

EVERSLEY IS ENTITLED TO RECOVER
INTEREST ON THE AMOUNTS DUE HEREIN.

The District Court awarded Eversley interest in both cases, computed from a date thirty (30) days following completion of construction (A18). This is in accord with other cases which have addressed similar issues.

Travelers Indemnity Company v. First National State Bank of New Jersey, supra, 328 F.Supp. at 217;

United States v. Lincoln Neighborhood Community Assn., supra, HUD Pamphlet at 9.

See, also, Royal Indemnity Company v. United States, 313 U.S. 289, 295-296 (1941).

Under Royal Indemnity, supra, the appropriate interest rate "is that prevailing in the state where the obligation was given and to be performed" (313 U.S. at 297). The Court will note that the rate of interest in New York is 6% per annum.

Insofar as the Government asserts that sovereign immunity bars recovery of interest herein, the Court is referred to 28 U.S.C. §2410(d), governing cases where the United States redeems property from a senior lien. In addition, it will be seen from the proposed HUD rules recently offered for comment (see page 20 of this brief, [footnote], and the proposed rules appended hereto), HUD is aware of this question concerning interest on withheld

funds and the Government's position as expressed in the HUD brief, and has expressed its intention to amend its rules accordingly in the contractor's favor. 41 Fed. Reg. 37226 (Vol. 41, September 2, 1976), col. 2.

CONCLUSION

For the reasons heretofore stated, the judgments of the District Court should be affirmed in all respects, with interest at the rate of 6% per annum from the dates of entry thereof.

Respectfully submitted,

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APPENDIX OF ADDITIONAL MATERIAL

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- 1-4. RELEASE OF HOLDBACK OF MORTGAGE PROCEEDS. In insurance of advance cases, the Building Loan Agreement requires the retention by the mortgagee of 10% of the construction proceeds at the time of each advance. This retention is one of the few sanctions HUD-FHA possesses to achieve as early a final closing of a loan as possible. Not until the time of the last advance is the holdback normally released. An earlier release of the funds could weaken the incentive on the part of the mortgagor and contractor to take the necessary steps to permit a final closing.
- a. Consent of Surety. There is only one absolute rule to be applied to a request for early release of the holdback--prior written consent of the surety.
 - b. Considerations by Field Office Director. With the consent of the surety in hand, the main factors the Field Office Director should consider are the percentage of completion at the time of the request, the amount of the holdback, the portion of the holdback requested to be released, and the contractor's performance up to the time the request for release is submitted.
 - c. Basis Before 90% of Construction. Prior to completion of 90% of construction, such a release should be permitted only if the Field Office Director is of the opinion the failure to do so would probably result in a default of the construction loan. If such release is granted, measures should be taken to make certain that the proceeds are disbursed immediately and principally for the benefit of the subcontractors.
 - d. Basis After 90% of Construction. After 90% of the construction has been completed, a release of up to 50% of the holdback should normally be permitted, provided the mortgagor and contractor are not primarily responsible for conditions causing the request for an early release, and also provided that there has been general compliance with HUD-FHA requirements by the mortgagor and contractor in the construction of the project to that point.
 - e. Basis For Further Release. Once there has been substantial completion of the project, acceptable cost certification has been filed, and an early final closing scheduled, the Field Office Director may, in his discretion, release 50% or more of the holdback, but in no event the entire amount thereof, bearing in mind that the undisbursed holdback provides a major incentive to the contractor to complete his performance.

1-6. PAYMENT FOR OFF-SITE FACILITIES. If an escrow deposit has been made to assure construction of off-site facilities under the provision of Escrow Agreement for Off-Site Facilities, FHA Form 2446, disbursements may be made from this escrow deposit as the construction of off-site facilities proceeds. These disbursements will be in proportion to the percentage of off-site work completed, less a holdback of 10%. The mortgagor will submit to the depository his request for payment, in quadruplicate, on Request for Approval of Advance of Escrow Funds, FHA Form 2464. The depository will complete its portion of the Form and submit it in triplicate to the Field Office Director. Upon receipt, the request will be routed to the DO/CU, for processing in accordance with underwriting procedures.

a. Disbursement In Order. After processing, the DO/CU will complete the form and submit it to the Field Office Director. Having determined that the disbursement is in order, the Field Office Director will execute the form and distribute it as follows:

(1) Original to the depository.

(2) Two copies to the DO/CU, (one copy for use of Finance and Mortgage Credit Section and one copy to be filed in the Washington Docket).

b. Disbursement Not In Order. If the Field Office Director finds that the disbursement is not in order, the request will be returned to the sponsor accompanied by a letter setting forth the reasons for denying the release of the escrow funds.

Register
Federal

THURSDAY, SEPTEMBER 2, 1976



PART III:

DEPARTMENT OF
HOUSING
AND URBAN
DEVELOPMENT

Office of Assistant Secretary
for Housing—
Federal Housing Commissioner
(FHA)



MORTGAGE AND LOAN
INSURANCE PROGRAMS;
MISCELLANEOUS
AMENDMENTS

Notice of Proposed Rulemaking

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Assistant Secretary for Housing
Production and Mortgage Credit—
Federal Housing Commissioner, (FHA)

[24 CFR Parts 205, 207, 213, 221, 231,
232, 241, 242, 244]

[Docket No. R-76-407]

MORTGAGE AND LOAN INSURANCE PROGRAMS UNDER THE NATIONAL HOUSING ACT

Miscellaneous Amendments; Notice of Proposed Rulemaking

The Department is proposing to amend Parts 207, 213, 221 and 231 of this chapter to reflect a change in policy with respect to the disbursement of mortgage proceeds for construction items under a construction contract where there is no identity of interest between the mortgagor and general contractor. Presently, in accordance with the provisions of the construction contract, the contractor is entitled to monthly payments for construction items in an amount equal to the value of the work acceptably completed and the materials stored on the site less 10 percent (holdback) and prior advances. The holdback is not released to the contractor until the project has been completed and the contractor, mortgagor and mortgagee have completed all requirements for a final loan closing, and the final advance is made. Thus, under these procedures, some contractors have suffered financial losses when they have completed the project and performed all the obligations under the construction contract, but the mortgage has not been finally endorsed for insurance because the mortgagor or the mortgagee has not met all requirements for closing, or the mortgage has gone into default subsequent to the completion of the project. When the contractor is not able to obtain the holdback because the final advance is not made by the mortgagee, a frequent result is that some of the subcontractors do not get paid.

The proposed amendments to the regulations will provide for a procedure whereby the contractor will make monthly requisitions to the mortgagor for payment of 100 percent of the value of the work acceptably completed since the last request for payment plus the value of the materials stored on the site. There will be no deduction in the contractor's request for the 10 percent holdback. Neither shall the mortgagor's proceeds for construction items contain a deduction for the 10 percent holdback. Both the contractor's requisition and the mortgagor's request for an advance will be predicated on the mortgagee's agreement that that portion of the advance which represents the 10 percent holdback will be retained by the mortgagee to be paid into an escrow account, minus an amount that is one and one-half times the cost estimated by HUD that is required for the completion of any minor incomplete on-site construction items, when the project had been substantially completed as determined by HUD. In the case where a cost plus form of contract

has been used, the mortgagee will not deposit the holdback monies into the escrow account until there has been both substantial completion of the project, as determined by HUD, and the mortgagee has been notified by the HUD field office having jurisdiction that the contractor has filed his "Contractor's Certificate of Actual Cost" with HUD. Disbursement from the escrow account will be made in accordance with the terms of an Escrow Agreement which shall provide for direct payment to the contractor upon notification from HUD that the contractor has complied with the conditions of the Escrow Agreement. The primary requirement in the Escrow Agreement which must be met before the contractor is entitled to the escrow account is the submission of his "Certificate of Actual Cost" and its approval by HUD. This will not be a requirement when the use of a lump sum contract has been approved by HUD in accordance with the regulations. When such a contract has been used, entitlement to the escrow account shall be automatic, except for the limitation on receipt of monies in excess of the contract amount.

When the project has been completed, as determined by HUD, there will be no requirement for the mortgagor to make a request to the mortgagee and HUD for an advance for the holdback, since the amount of the holdback will have been included in each of the mortgagor's requests from the start of construction. The contractor, with the prior approval of HUD, can make the request directly to the mortgagee for disbursement of the holdback to the escrow account. The mortgagee will not have disbursed from mortgage proceeds the amount of the holdback until it is placed in the escrow account, and, thus, the mortgagee will not be entitled to interest from the mortgagor on the amount of the holdback until it is placed in the escrow account. The amount of the holdback will be insured by HUD when it is put in the escrow account.

The proposed regulations require that the holdback be placed in an escrow account which may be an interest bearing account if the mortgagor and general contractor have so agreed. Any interest earned shall be turned over to the contractor.

The Department is limiting the applicability of the proposed regulations to those projects where there is no identity of interest between the mortgagor and general contractor. It was considered that where a contractor has an identity of interest with the mortgagor, such contractor has provided the leverage necessary to protect itself against a mortgagor who, through inaction or default, prevents a final closing.

As mentioned above, one of the considerations in this proposal was to provide the release of funds which could be used to pay subcontractors. However, the proposed regulations will not eliminate any other requirements in the regulations, or in the contractual documents used in the mortgage insurance transaction, for subcontractors to submit certificates of actual cost.

There are several HUD legal forms and documents used in mortgage insurance transactions which must be amended if these regulations are adopted. The amendments will reflect the procedures as set forth in the proposed regulations.

The proposed regulations are to apply prospectively, but in those cases where a construction contract has already been executed at the time the regulations are finally adopted, the appropriate legal documents can be amended to reflect the new procedures if all the parties to the insurance transaction, including HUD, agree.

The Department is also proposing additional amendments to those parts noted above as well as amendments to Parts 205, 232, 241, 242 and 244, to require that every construction contract contain a provision obligating the general contractor to give a copy of the "Contractor's and/or Mortgagee's Cost Breakdown" to each subcontractor, to inform each subcontractor of each draw under the contract, and, when applying for a draw, to submit appropriate receipts or waivers from each subcontractor for work covered by previous draws. The Department is proposing this change to enable subcontractors to be better informed so that they may more effectively protect their interests.

Interested persons are invited to participate in this proposed rulemaking by submitting written data, views and suggestions. Communications should identify the subject matter by title and docket number and should be filed with the Rules Docket Clerk, Office of the Secretary, Room 10141, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, D.C. 20410. All relevant material received on or before October 4, 1976, will be considered before adoption of the final rule. Copies of comments received will be available for examination during business hours at the above address.

The Department has determined that an Environmental Impact Statement is not required with respect to this rule. The Finding of Inapplicability, in accordance with HUD's environmental procedures handbook (HUD Handbook 1390.1, is available for inspection at the Office of the Rules Docket Clerk, at the above address.

Accordingly, it is proposed that Parts 205, 207, 213, 221, 231, 232, 241, 242 and 244 of Chapter II of Title 24 of the Code of Federal Regulations be amended to read as follows:

PART 205—MORTGAGE INSURANCE FOR LAND DEVELOPMENT (TITLE X)

1. Section 205.112 is amended by adding a new paragraph (c) to read as follows:

§ 205.112 Form of contract.

(c) Provisions regarding subcontractors. The lump sum and fixed fee construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractors and/or Mortgagee's Cost Breakdown" to

each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for the work covered by the previous draw.

PART 207—MULTIFAMILY HOUSING MORTGAGE INSURANCE

2. Subpart A of the Table of Contents to Part 207 is amended to include a new section numbered § 207.26a and designated, "Disposition of general contractor's holdback," as follows:

Sec.
207.26a Disposition of general contractor's holdback.

3. Section 207.26 is amended by placing the letter (a) before the introductory language, redesignating paragraphs (a), (b), (c) and (d) to (1), (2), (3) and (4) respectively, and by adding a new paragraph (b) to read as follows:

§ 207.26 Form of contract.

(b) The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

4. The following new section is added and designated as § 207.26a:

§ 207.26a Disposition of general contractor's holdback.

In those cases in which a construction contract has been executed after -----, and there is no identity of interest between the mortgagor and general contractor, the following provisions shall be applicable:

(a) The construction contract, whether it be lump sum or cost plus, shall contain provisions whereby the mortgagor and contractor agree that the general contractor:

(1) Shall submit to the mortgagor, on a monthly basis, a requisition for payment equal to the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior payments made to the general contractor;

(2) Shall accept, for each and every requisition, 90 percent of the amount approved for payment, and shall agree that the remaining 10 percent shall be retained by the mortgagee to be deposited in an escrow account when the construction of the project has been substantially completed, with the exception of minor incomplete on-site construction items, and the following requirements have been met:

(i) All work under the construction contract, requiring inspection by municipal

pal or other governmental authorities having jurisdiction, has been inspected and approved by such authorities and by the rating or inspection organization, bureau, association or office having jurisdiction; (ii) All required certificates of occupancy or other approvals, with respect to all units of the project, have been issued by State or local governmental authorities having jurisdiction; (iii) Permissions to occupy for all units of the project have been issued by the Commissioner; and (iv) In the event a cost-plus form of contract has been used, that the mortgagee has been notified by the HUD field office that the mortgagor has filed the "Contractor's Certificate of Actual Cost" with the Commissioner, except that, if the mortgagor fails or refuses to file such a certificate within a reasonable time, the general contractor's direct submission of the certificate of actual cost may be the basis for the HUD field office notification and the establishment of the escrow.

(3) Shall be entitled to the funds in the escrow account upon compliance with the terms of the Escrow Agreement which shall contain the conditions for release of the escrow account to the general contractor; and

(b) The building loan agreement shall provide that:

(1) The mortgagor shall request monthly from the mortgagee an advance of mortgage proceeds for construction items in the amount of the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior advances;

(2) The mortgagor shall accept, for each and every advance, 90 percent of the amount of advance approved;

(3) The mortgagee shall retain the remaining 10 percent of each approved advance;

(4) The mortgagee shall transfer the 10 percent holdback for each advance, minus an amount that is one and one-half times the cost estimated by the Commissioner that is required for the completion of any minor incomplete on-site construction items, to an escrow account when the general contractor completes the construction as determined by the Commissioner and meets the requirements set forth in paragraphs (a) (2) (i), (ii) and (iii), and (a) (2) (i), (ii), (iii) and (iv) of this section for a general contractor who has executed a lump sum form of contract or cost plus form of contract, respectively.

(5) The 10 percent holdback shall not be construed as an advance from mortgage proceeds by the mortgagee until the mortgagee places the funds in an escrow account in accordance with paragraph (b) (4) of this section; and

(6) The mortgagee and mortgagor agree that, notwithstanding the inclusion in the building loan agreement of the provisions contained in paragraphs (b) (1) through (5) of this section, the mortgagee is not required to make any advance of mortgage proceeds if the mortgagor is in default under the build-

ing loan agreement, other than the advance of the 10 percent holdback in accordance with paragraph (b) (4) of this section, and, except as altered by the provisions of this paragraph, the rights and obligations of the mortgagee and mortgagor under the building loan agreement shall not be affected.

(c) An Escrow Agreement shall be established for the purposes set forth in paragraphs (a) and (b) of this section and the depository under such agreement shall be either the mortgagee or a party designated by the mortgagee. The agreement shall contain provisions for the release of the escrow fund which shall include the requirement that the general contractor submit its certificate of actual cost for approval by the Commissioner and that the certificate be approved by the Commissioner before the contractor shall be entitled to the fund. If the mortgagor and general contractor have entered into a lump sum contract, the requirement for the certificate of actual cost shall not be applicable. The Escrow Agreement shall provide that the depository will:

(1) Release the funds upon request of the general contractor and approval of the Commissioner;

(2) Invest the funds in an interest bearing account, if the mortgagor and general contractor have so agreed, which interest shall be paid to the general contractor when the escrowed funds are released to the general contractor; and

(3) Release to the general contractor only that portion of the escrowed funds which do not exceed the amount of costs approved by the Commissioner on the "Contractor's Certificate of Actual Cost", or, in the case of a general contractor which has entered into a lump sum contract, an amount, which when added to payments already received, does not exceed the amount of the lump sum contract.

(d) The mortgagee's request for approval by the Commissioner of an advance for construction items shall contain a provision that such approval by the Commissioner shall constitute approval for mortgage insurance of the 10 percent holdback retained by the mortgagee when the retained funds are placed in an escrow account in accordance with this section. The mortgage insurance on the funds retained by the mortgagee shall be effective on the date the funds are transferred to the escrow account.

PART 213—COOPERATIVE HOUSING MORTGAGE INSURANCE

5. Subpart A of the Table of Contents to Part 213 is amended to include a new section numbered § 213.34a and designated, "Disposition of general contractor's holdback," as follows:

Sec.
213.34a Disposition of general contractor's holdback.

6. Section 213.34 is amended by placing the letter (a) before the introductory language, redesignating paragraphs (a), (b) and (c) to (1), (2) and (3) respec-

tively, and by adding a new paragraph (b) to read as follows:

§ 213.34 Form of contract.

(b) The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

7. The following new section is added and designated as 213.34a:

§ 213.34a Disposition of general contractor's holdback.

In those cases in which a construction contract has been executed after -----, and there is no identity of interest between the mortgagor and general contractor, the following provisions shall be applicable:

(a) The construction contract, whether it be lump sum or cost plus, shall contain provisions whereby the mortgagor and contractor agree that the general contractor:

(1) Shall submit to the mortgagor, on a monthly basis, a requisition for payment equal to the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior payments made to the general contractor;

(2) Shall accept, for each and every requisition, 90 percent of the amount approved for payment, and shall agree that the remaining 10 percent shall be retained by the mortgagee to be deposited in an escrow account when the construction of the project has been substantially completed, with the exception of minor incomplete on-site construction items, and the following requirements have been met:

(i) All work under the construction contract, requiring inspection by municipal or other governmental authorities having jurisdiction, has been inspected and approved by such authorities and by the rating or inspection organization, bureau, association or office having jurisdiction; (ii) All required certificates of occupancy or other approvals, with respect to all units of the project, have been issued by State or local governmental authorities having jurisdiction; (iii) Permissions to occupy for all units of the project have been issued by the Commissioner; and (iv) In the event a cost-plus form of contract has been used, that the mortgagee has been notified by the HUD field office that the mortgagor has filed the "Contractor's Certificate of Actual Cost" with the Commissioner, except that, if the mortgagor fails or refuses to file such a certificate within a reasonable time, the general contractor's direct submission of the certificate of actual cost may be the basis for the HUD field office notification and the establishment of the escrow.

(3) Shall be entitled to the funds in the escrow account upon compliance with the terms of the Escrow Agreement which shall contain the conditions for release of the escrow account to the general contractor; and

(b) The building loan agreement shall provide that:

(1) The mortgagor shall request monthly from the mortgagee an advance of mortgage proceeds for construction items in the amount of the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior advances;

(2) The mortgagor shall accept, for each and every advance, 90 percent of the amount of advance approved;

(3) The mortgagee shall retain the remaining 10 percent of each approved advance;

(4) The mortgagee shall transfer the 10 percent holdback for each advance, minus an amount that is one and one-half times the cost estimated by the Commissioner that is required for the completion of any minor incomplete on-site construction items, to an escrow account when the general contractor completes the construction as determined by the Commissioner and meets the requirements set forth in paragraphs (a) (2) (i), (ii) and (iii), and (a) (2) (i), (ii), (iii) and (iv) of this section for a general contractor who has executed a lump sum form of contract or cost plus form of contract, respectively.

(5) The 10 percent holdback shall not be construed as an advance from mortgage proceeds by the mortgagee until the mortgagee places the funds in an escrow account in accordance with paragraph (b) (4) of this section; and

(6) The mortgagee and mortgagor agree that, notwithstanding the inclusion in the building loan agreement of the provisions contained in paragraphs (b) (1) through (5) of this section, the mortgagee is not required to make any advance of mortgage proceeds if the mortgagor is in default under the building loan agreement, other than the advance of the 10 percent holdback in accordance with paragraph (b) (4) of this section, and, except as altered by the provisions of this paragraph, the rights and obligations of the mortgagee and mortgagor under the building loan agreement shall not be affected.

(c) An Escrow Agreement shall be established for the purposes set forth in paragraphs (a) and (b) of this section and the depository under such agreement shall be either the mortgagee or a party designated by the mortgagee. The agreement shall contain provisions for the release of the escrow fund which shall include the requirement that the general contractor submit its certificate of actual cost for approval by the Commissioner and that the certificate be approved by the Commissioner before the contractor shall be entitled to the fund. If the mortgagor and general contractor have entered into a lump sum contract, the requirement for the certificate of actual cost shall not be applicable. The Escrow

Agreement shall provide that the depository will:

(1) Release the funds upon request of the general contractor and approval of the Commissioner;

(2) Invest the funds in an interest bearing account, if the mortgagor and general contractor have so agreed, which interest shall be paid to the general contractor when the escrowed funds are released to the general contractor; and

(3) Release to the general contractor only that portion of the escrowed funds which do not exceed the amount of costs approved by the Commissioner on the "Contractor's Certificate of Actual Cost", or, in the case of a general contractor which has entered into a lump sum contract, an amount, which when added to payments already received, does not exceed the amount of the lump sum contract.

(d) The mortgagee's request for approval by the Commissioner of an advance for construction items shall contain a provision that such approval by the Commissioner shall constitute approval for mortgage insurance of the 10 percent holdback retained by the mortgagee when the retained funds are placed in an escrow account in accordance with this section. The mortgage insurance on the funds retained by the mortgagee shall be effective on the date the funds are transferred to the escrow account.

PART 221—LOW COST AND MODERATE INCOME MORTGAGE INSURANCE

8. Subpart C of the Table of Contents to Part 221 is amended to include a new section numbered § 221.548a and designated, "Disposition of general contractor's holdback," as follows:

Sec.

221.548a Disposition of general contractor's holdback.

9. Section 221.548 is amended by adding a new paragraph (d) to read as follows:

§ 221.548 Form of contract.

(d) Provisions regarding subcontractors. The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

10. The following new section is added and designated as § 221.548a.

§ 221.548a Disposition of general contractor's holdback.

In those cases in which a construction contract has been executed after -----, and there is no identity of interest between the mortgagor and general contractor, the following provisions shall be applicable:

(a) The construction contract, whether it be lump sum or cost plus, shall contain provisions whereby the mortgagor

and contractor agree that the general contractor:

(1) Shall submit to the mortgagor, on a monthly basis, a requisition for payment equal to the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior payments made to the general contractor;

(2) Shall accept, for each and every requisition, 90 percent of the amount approved for payment, and shall agree that the remaining 10 percent shall be retained by the mortgagee to be deposited in an escrow account when the construction of the project has been substantially completed, with the exception of minor incomplete on-site construction items, and the following requirements have been met:

(i) All work under the construction contract, requiring inspection by municipal or other governmental authorities having jurisdiction, has been inspected and approved by such authorities and by the rating or inspection organization, bureau, association or office having jurisdiction; (ii) All required certificates of occupancy or other approvals, with respect to all units of the project, have been issued by State or local governmental authorities having jurisdiction; (iii) Permits to occupy for all units of the project have been issued by the Commissioner; and (iv) In the event a cost-plus form of contract has been used, that the mortgagee has been notified by the HUD field office that the mortgagor has filed the "Contractor's Certificate of Actual Cost" with the Commissioner, except that, if the mortgagor fails or refuses to file such a certificate within a reasonable time, the general contractor's direct submission of the certificate of actual cost may be the basis for the HUD field office notification and the establishment of the escrow.

(3) Shall be entitled to the funds in the escrow account upon compliance with the terms of the Escrow Agreement which shall contain the conditions for release of the escrow account to the general contractor; and

(b) The building loan agreement shall provide that:

(1) The mortgagor shall request monthly from the mortgagee an advance of mortgage proceeds for construction items in the amount of the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior advances;

(2) The mortgagor shall accept, for each and every advance, 90 percent of the amount of advance approved;

(3) The mortgagee shall retain the remaining 10 percent of each approved advance;

(4) The mortgagee shall transfer the 10 percent holdback for each advance, minus an amount that is one and one-half times the cost estimated by the Commissioner that is required for the completion of any minor incomplete on-site construction items, to an escrow account when the general contractor completes the construction as determined by the

Commissioner and meets the requirements set forth in paragraphs (a) (2) (i), (ii) and (iii), and (a) (2) (i), (ii), (iii) and (iv) of this section for a general contractor who has executed a lump sum form of contract or cost plus form of contract, respectively.

(5) The 10 percent holdback shall not be construed as an advance from mortgage proceeds by the mortgagee until the mortgagee places the funds in an escrow account in accordance with paragraph (b) (4) of this section; and

(6) The mortgagee and mortgagor agree that, notwithstanding the inclusion in the building loan agreement of the provisions contained in paragraphs (b) (1) through (5) of this section, the mortgagee is not required to make any advance of mortgage proceeds if the mortgagor is in default under the building loan agreement, other than the advance of the 10 percent holdback in accordance with paragraph (b) (4) of this section, and, except as altered by the provisions of this paragraph, the rights and obligations of the mortgagee and mortgagor under the building loan agreement shall not be affected.

(c) An Escrow Agreement shall be established for the purposes set forth in paragraphs (a) and (b) of this section and the depository under such agreement shall be either the mortgagee or a party designated by the mortgagee. The agreement shall contain provisions for the release of the escrow fund which shall include the requirement that the general contractor submit its certificate of actual cost for approval by the Commissioner and that the certificate be approved by the Commissioner before the contractor shall be entitled to the fund. If the mortgagor and general contractor have entered into a lump sum contract, the requirement for the certificate of actual cost shall not be applicable. The Escrow Agreement shall provide that the depository will:

(1) Release the funds upon request of the general contractor and approval of the Commissioner;

(2) Invest the funds in an interest bearing account, if the mortgagor and general contractor have so agreed, which interest shall be paid to the general contractor when the escrowed funds are released to the general contractor; and

(3) Release to the general contractor only that portion of the escrowed funds which do not exceed the amount of costs approved by the Commissioner on the "Contractor's Certificate of Actual Cost", or, in the case of a general contractor which has entered into a lump sum contract, an amount, which when added to payments already received, does not exceed the amount of the lump sum contract.

(d) The mortgagee's request for approval by the Commissioner of an advance for construction items shall contain a provision that such approval by the Commissioner shall constitute approval for mortgage insurance of the 10 percent holdback retained by the mortgagee when the retained funds are placed in an escrow account in accordance with this section. The mortgage insurance on

the funds retained by the mortgagee shall be effective on the date the funds are transferred to the escrow account.

PART 231—HOUSING MORTGAGE INSURANCE FOR THE ELDERLY

11. Subpart A of the Table of Contents to Part 231 is amended to include a new section numbered § 231.10c and designated, "Disposition of general contractor's holdback," as follows:

Sec.

231.10c Disposition of general contractor's holdback.

12. Section 231.10b is amended by adding a new paragraph (d) to read as follows:

§ 231.10b. Form of contract.

(d) Provisions regarding subcontractors. The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor:

(1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

13. The following new section is added and designated as 231.10c:

§ 231.10c Disposition of general contractor's holdback.

In those cases in which a construction contract has been executed after -----, and there is no identity of interest between the mortgagor and general contractor, the following provisions shall be applicable:

(a) The construction contract, whether it be lump sum or cost plus, shall contain provisions whereby the mortgagor and contractor agree that the general contractor:

(1) Shall submit to the mortgagor, on a monthly basis, a requisition for payment equal to the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior payments made to the general contractor;

(2) Shall accept, for each and every requisition, 90 percent of the amount approved for payment, and shall agree that the remaining 10 percent shall be retained by the mortgagee to be deposited in an escrow account when the construction of the project has been substantially completed, with the exception of minor incomplete on-site construction items, and the following requirements have been met:

(i) All work under the construction contract, requiring inspection by municipal or other governmental authorities having jurisdiction, has been inspected and approved by such authorities and by the rating or inspection organization, bureau, association or office having jurisdiction; (ii) All required certificates of occupancy or other approvals, with re-

spect to all units of the project, have been issued by State or local governmental authorities having jurisdiction; (iii) Permissions to occupy for all units of the project have been issued by the Commissioner; and (iv) In the event a cost-plus form of contract has been used, that the mortgagee has been notified by the HUD field office that the mortgagor has filed the "Contractor's Certificate of Actual Cost" with the Commissioner, except that, if the mortgagor fails or refuses to file such a certificate within a reasonable time, the general contractor's direct submission of the certificate of actual cost may be the basis for the HUD field office notification and the establishment of the escrow.

(3) Shall be entitled to the funds in the escrow account upon compliance with the terms of the Escrow Agreement which shall contain the conditions for release of the escrow account to the general contractor; and

(b) The building loan agreement shall provide that:

(1) The mortgagor shall request monthly from the mortgagee an advance of mortgage proceeds for construction items in the amount of the total value of classes of work acceptably completed plus the value of materials and equipment not incorporated in the work but delivered to, and suitably stored at, the site, less prior advances;

(2) The mortgagor shall accept, for each and every advance, 90 percent of the amount of advance approved;

(3) The mortgagee shall retain the remaining 10 percent of each approved advance;

(4) The mortgagee shall transfer the 10 percent holdback for each advance, minus an amount that is one and one-half times the cost estimated by the Commissioner that is required for the completion of any minor incomplete on-site construction items, to an escrow account when the general contractor completes the construction as determined by the Commissioner and meets the requirements set forth in paragraphs (a) (2) (i), (ii) and (iii), and (a) (2) (i), (ii), (iii) and (iv) of this section for a general contractor who has executed a lump sum form of contract or cost plus form of contract, respectively.

(5) The 10 percent holdback shall not be construed as an advance from mortgage proceeds by the mortgagee until the mortgagee places the funds in an escrow account in accordance with paragraph (b) (4) of this section; and

(6) The mortgagee and mortgagor agree that, notwithstanding the inclusion in the building loan agreement of the provisions contained in paragraphs (b) (1) through (5) of this section, the mortgagee is not required to make any advance of mortgage proceeds if the mortgagor is in default under the building loan agreement, other than the advance of the 10 percent holdback in accordance with paragraph (b) (4) of this section, and, except as altered by the provisions of this paragraph, the rights and obligations of the mortgagee and mortgagor under the building loan agreement shall not be affected.

(c) An Escrow Agreement shall be established for the purposes set forth in paragraphs (a) and (b) of this section and the depository under such agreement shall be either the mortgagee or a party designated by the mortgagee. The agreement shall contain provisions for the release of the escrow fund which shall include the requirement that the general contractor submit its certificate of actual cost for approval by the Commissioner and that the certificate be approved by the Commissioner before the contractor shall be entitled to the fund. If the mortgagor and general contractor have entered into a lump sum contract, the requirement for the certificate of actual cost shall not be applicable. The Escrow Agreement shall provide that the depository will:

(1) Release the funds upon request of the general contractor and approval of the Commissioner;

(2) Invest the funds in an interest bearing account, if the mortgagor and general contractor have so agreed, which interest shall be paid to the general contractor when the escrowed funds are released to the general contractor; and

(3) Release to the general contractor only that portion of the escrowed funds which do not exceed the amount of costs approved by the Commissioner on the "Contractor's Certificate of Actual Cost", or, in the case of a general contractor which has entered into a lump sum contract, an amount, which when added to payments already received, does not exceed the amount of the lump sum contract.

(d) The mortgagee's request for approval by the Commissioner of an advance for construction items shall contain a provision that such approval by the Commissioner shall constitute approval for mortgage insurance of the 10 percent holdback retained by the mortgagee when the retained funds are placed in an escrow account in accordance with this section. The mortgage insurance on the funds retained by the mortgagee shall be effective on the date the funds are transferred to the escrow account.

PART 232—NURSING HOMES AND INTERMEDIATE CARE FACILITIES MORTGAGE INSURANCE

14. Section 232.81 is amended by adding a new paragraph (e) to read as follows:

§ 232.81 Form of contract.

(e) Provisions regarding subcontractors. The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

PART 241—SUPPLEMENTARY FINANCING FOR INSURED PROJECT MORTGAGES

15. Section 241.160 is amended by adding a new paragraph (i) to read as follows:

§ 241.160 Cost certification requirements; loans over \$200,000.

(i) The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor covering work for the previous draw.

PART 242—MORTGAGE INSURANCE FOR HOSPITALS

16. Section 242.69 is amended by adding a new paragraph (d) to read as follows:

§ 242.69 Construction contracts.

(d) The construction contract shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

PART 244—MORTGAGE INSURANCE FOR GROUP PRACTICE FACILITIES (TITLE XI)

17. Section 244.145 is amended by placing the letter (a) before the sentence presently contained in the section and adding a new paragraph (b) to read as follows:

§ 244.145 Form of contract.

(b) The lump sum and cost plus construction contracts shall contain a provision requiring the general contractor: (1) To give a copy of the "Contractor's and/or Mortgagor's Cost Breakdown" to each subcontractor, (2) To inform every subcontractor of each draw under the contract, including the release of any holdback, and (3) When applying for a draw, to submit appropriate receipts and waivers from each subcontractor for work covered by the previous draw.

(Sec. 7(d), Department of HUD Act; 42 U.S.C. 3535(d).)

NOTE.—It is hereby certified that the economic and inflationary impacts of this proposed regulation have been carefully evaluated in accordance with OMB Circular A-107).

Issued at Washington, D.C. August 27, 1976.

JAMES L. YOUNG,
Assistant Secretary for Housing,
Federal Housing Commissioner.

[FR Doc.76-25784 Filed 9-1-76; 8:45 am]

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

ROBERT LA GRASSA, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 62-20 60th Rd.
MASPETH, N.Y.C.

That on the 12th day of October, 19 76,
deponent personally served the within BRIEF FOR
PLAINTIFF-APPELLEES
upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose.

~~By leaving true copies of same with a duly
authorized person at their designated office.~~

By depositing 2 true copies of same enclosed
in a postpaid properly addressed wrapper, in the post office
or official depository under the exclusive care and custody
of the United States post office department within the State
of New York.

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses.

ROBERT B. FISKE, JR., ESQ.

U. S. Attorney for the Southern District of New York
Attorney for Defendant-Appellant Hills in both appeals
One St. Andrews Plaza
New York, N. Y.
Attention: PETER C. SALERNO, ESQ., Assistant U.S. Attorney

MESSRS. WEISMAN, CELLER, SPETT,

MODLIN, WERTHEIMER and SCHLESINGER
Attorneys for Defendant-Appellant Manufacturers Hanover Trust Co.
in Docket No. 76-6097
425 Park Avenue
New York, N. Y. 10022
Attention: SAMUEL R. RUDEY, ESQ.

Robert La Grassa

Sworn to before me this

12th day of October, 19 76.

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County
Commission Expires March 30, 1978